No. 90-693

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1990

CURTIS REED JOHNSON,
*Petitioner,*

vs.

HOME STATE BANK,
*Respondents.*

## ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

## BRIEF OF AMICUS CURIAE THE KANSAS BANKERS ASSOCIATION IN SUPPORT OF THE POSITION OF RESPONDENT HOME STATE BANK

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## INTEREST OF AMICUS CURIAE

The Kansas Bankers Association is a trade association having as its members substantially all of the commercial banks having their principal place of business in the State of Kansas. All Kansas banks have a significant interest in a balanced construction of the Bankruptcy Code consistent with Congressional intent.

This specific case arose from a rural bank's extension of agricultural credit secured by a mortgage of farm property. Many Kansas banks have a substantial portion of their loan portfolios in such agricultural lending, and continued financing of small agricultural operators will be promoted by a clear delineation of the extent to which successive bankruptcy petitions can be utilized to bar foreclosure. The Tenth Circuit's analysis correctly protects the right of agricultural lenders to foreclose on real property following a farmer's discharge in a Chapter 7 proceeding, notwithstanding the filing of a subsequent Chapter 13 proceeding. The Kansas Bankers Association therefore urges that either the Tenth Circuit's analysis be affirmed by this Court or an alternative, objective standard be adopted under the good faith criteria of 11 U.S.C. §1325(a)(3)[1] which bars use of Chapter 13 following discharge under Chapter 7 to frustrate a lender's sale of mortgaged real property.

## SUMMARY OF ARGUMENT

The Tenth Circuit found that Congress did not intend to permit a Chapter 13 proceeding to be used to reschedule the payment of an in rem remedy where the debtor's obligation had been previously discharged in a

[1]11 U.S.C. §1325(a)(3) provides:

> (a) Except as provided in subsection (b) the court shall confirm a plan if--
>
> • • •
>
> (3) the plan has been proposed in good faith and not by any means forbidden by law; . . .



Chapter 7 proceeding.[2] The Court construed the Code definitions to preclude use of Chapter 13 for this purpose as a matter of law. Respondent, The Home State Bank, in its brief to this Court, thoroughly examines these issues of Code construction. Amicus Curiae submits that in the event this Court disagrees with the Tenth Circuit's construction of the Code, the result of the Tenth Circuit should be affirmed under an alternative rationale. The good faith criteria of 11 U.S.C. §1325(a)(3) provides the vehicle for doing so. Amicus urges adoption of a per se standard of bad faith which prohibits Chapter 13 plans which propose to adjust only in rem "debts" which were discharged in a prior Chapter 7 proceeding, where there has been no intervening substantial change in circumstances between the filing of the Chapter 7 case and the subsequent Chapter 13 petition.

## ARGUMENT

This case presents the court with an opportunity to review what has become known as a "Chapter 20" case.[3] In such cases, the claims which are involved in the Chapter 13 case, which is filed subsequent to discharge in a Chapter 7, are only those the debtor has incurred after the start of the original Chapter 7 and any claims which were not discharged in the Chapter 7, together with any liens which survived the Chapter 7 discharge.[4] The two most common motives for such serial filings are to achieve a continuing

[2]Petition for Cert. App. 5.

[3]Morris, *Serial Bankruptcies and Good Faith in Chapter 20*, 1 Falkner and Gray Bankr. L. Rev. 48 (1990).

[4]*Id.*, at 48-49.

reimposition of the automatic stay to bar foreclosure of liens remaining after Chapter 7 discharge and to discharge, after nominal payments in the Chapter 13 plan, a debt which was nondischargeable in the prior Chapter 7.[5] Frequently the real property which the Chapter 13 debtor seeks to protect from foreclosure sale is his or her home.[6] This case presents a somewhat less common but similar situation where the debts to be dealt with by the Chapter 13 plan are liens on non-residential real estate which because of the prior Chapter 7 discharge are in rem remedies only.

The Bankruptcy Code restraints upon successive filings are minimal. The only code section directly addressing the issue is Section 109(g), which was added to the Code in 1984.[7] It prohibits an individual or a family farmer from refiling bankruptcy within 180 days of the dismissal of a prior proceeding which was dismissed by the Court for willful failure of the debtor to abide by orders or to appear in the case or where the debtor requested and obtained a voluntary dismissal following the filing of a request for relief from automatic stay. "The rationale underlying Section 109(g) is that debtors should not be permitted to disrupt the court's processing of bankruptcy cases."[8] Other less direct restraints against multiple relief under the

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[5]*In re Russo*, 94 B.R. 127, 128 (Bankr. N.D. Ill. 1988).

[6]*See e.g., In re Metz*, 67 B.R. 462 (9th Cir. BAP 1986); *In re Ligon*, 97 B.R. 398 (Bankr.N.D.Ill. 1989).

[7]Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, 98 Stat. 352, Title III, Section 301 (1984).

[8]Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 Wm & Mary L. Rev. 91, 101 (1985).



Code include Section 727(a)(8), which prevents a debtor from obtaining a Chapter 7 discharge more than once every six years, and Section 727(a)(9), which precludes a debtor from obtaining a Chapter 7 discharge within six years of a Chapter 12 or Chapter 13 discharge, except under limited circumstances.

Collectively, the foregoing Code provisions do not address in a comprehensive manner the problem posed by multiple filings. This has led one court to conclude, "It is fair to surmise that Congress did not anticipate the problem, therefore few statutory restraints exist in the Code."[9]

Absent an express Code prohibition of Chapter 20 cases, courts have turned to the good faith provision of 11 U.S.C. §1325(a)(3) as a means to monitor whether successive filings are abusive.[10] Although the criteria of 1325(a)(3) that a Chapter 13 plan be "proposed in good faith" is of fundamental importance, the term "good faith" is not defined in either the Code or its legislative history. Likewise, the issue has not been addressed by this Court.

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[9]*In re Russo*, 94 B.R. 127, 128 (Bankr. N.D. Ill. 1988).

[10]*E.g. Matter of Metz*, 820 F.2d 1495 (9th Cir. 1987) (Chapter 20). *See also In re Chisum*, 847 F.2d 597 (9th Cir. 1988) (Chapter 7 following three Chapter 13 petitions); and *In re Penz*, 121 B.R. 602 (Bankr. E.D. Okla. 1990) (bad faith filing of Chapter 12 after three prior Chapter 12 and Chapter 7 petitions).

Courts generally apply a multiple factor test[11] which evaluates the totality of the circumstances on a case by case basis.[12]

The good faith criteria provides a broad equitable vehicle by which Congress provided the bankruptcy courts with a "discretionary means to preserve the bankruptcy process for its intended purpose."[13] The good faith standard stands as a means to police the "manipulation of the bankruptcy system."[14] "To answer the question of good faith or lack thereof, the Court is ultimately required to determine whether or not there has been an abuse of the provisions, purpose, or spirit of Chapter 13."[15] Any plan inconsistent with the purpose of Chapter 13 is proposed in bad faith.[16]

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[11]A frequently cited list of factors is enumerated in *In re Estus*, 695 F.2d 311 (8th Cir. 1982).

[12]*E.g. Deans v. O'Donnell*, 692 F.2d 968 (4th Cir. 1982); *In re Caldwell*, 895 F.2d 1123 (6th Cir. 1990); *Matter of Smith*, 848 F.2d 813 (7th Cir. 1988); *In re LeMaire*, 898 F.2d 1346 (8th Cir. 1990); *In re Chisum*, 847 F.2d 597 (9th Cir. 1988); *In re Rasmussen*, 888 F.2d 703 (10th Cir. 1989); and *In re Kitchens*, 702 F.2d 885 (11th Cir. 1983).

[13]*In re Waldron*, 785 F.2d 936, 941 (11th Cir. 1986).

[14]*In re Rasmussen*, 888 F.2d 703, 706 (10th Cir. 1989). *See also Neufeld v. Freeman*, 794 F.2d 149, 152-53 (4th Cir. 1986).

[15]*Matter of Jones*, 119 B.R. 996, 1002 (Bankr. N.D. Ind. 1990) citing *Matter of Smith*, 848 F.2d 813, 818 (7th Cir. 1988).

[16]Roszkowski, *Good Faith and Chapter 13*, 46 Bus. Law. 67, 80 (1990).



"The purpose of chapter 13 is to enable an individual, under court supervision and protection, to develop and perform under a plan for the repayment of his debts over an extended period of time."[17]

> . . . The new chapter 13 will permit almost any individual with regular income to propose and have approved a reasonable plan for debt repayment based upon that individual's exact circumstances. As in current law, 100% payment plans will be encouraged by the limitation on availability of a subsequent discharge in section 727(a)(8). This kind of plan has provided great self-satisfaction and pride to those debtors who complete them and at the same time effect a maximum return to creditors. The limitation of §727(a)(8) will also provide a slight break on the wholesale filings of Chapter 13's by small businessmen who wish to avoid some of the restrictions of Chapter 11. It is also necessary to prevent Chapter 13 plans from turning into mere offers of composition plans under which payments would equal only the nonexempt assets of the debtor.[18]

The legislative history reflects congressional intent that an eligible debtor is to choose between Chapter 13 and Chapter 7. The House report states, "[T]he benefit to the debtor of developing a plan of repayment under Chapter 13, *rather than opting for liquidation under Chapter 7*, is that

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[17]H. R. 595, 95th Cong., 1st Sess. 118 (1977).

[18]S. Rep. No. 989, 95th Cong., 2d Sess. 13 (1978).

it permits the debtor to protect his assets."[19] Chapter 13, both under the Bankruptcy Act and the Code, was viewed as a means to "permit an individual to pay his debts and *avoid* bankruptcy by making periodic payments."[20] When an individual files a Chapter 7 liquidation proceeding, that individual is using the Bankruptcy Code for a purpose different from that contemplated by Chapter 13.

> Some consumer debtors are unable to avail themselves of the relief provided under Chapter 13. For these debtors, straight bankruptcy is the only remedy that will enable them to get out from under the debilitating effects of too much debt. The purpose of straight bankruptcy for them is to obtain a fresh start, free from creditor harassment and free from the worries and pressures of too much debt.. . .[21]

Congress provided a system of exemption,[22] redemption,[23] and reaffirmation[24] provisions by which debtors in a Chapter 7 are able to retain certain assets. Apart from assets protected by the debtor through these

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[19]H. Rep. No. 595, 95th Cong., 1st Sess. 118 (1977) (emphasis supplied).

[20]S. Rep. No. 989, 95th Cong., 2d Sess. 12 (1978) (emphasis supplied).

[21]H. R. Rep. No. 595, 95th Cong., 1st Sess. 125 (1977).

[22]11 U.S.C. §522 (Supp. IV 1986)

[23]11 U.S.C. §722 (1982)

[24]11 U.S.C. §524(c) (Supp. IV 1986)



provisions, it is the scheme of the Code that Chapter 7 debtors will generally not retain pre-bankruptcy assets.[25]

There is no legislative history indicating that Congress intended debtors to achieve the unique set of benefits resulting from a Chapter 20. It has been suggested that if Congress intended such a combination of relief, it would have expressly so provided.[26] Chapter 7 and Chapter 13 are separately crafted legislative schemes having different purposes. The legislative history cited above evidences intent that a debtor is entitled to relief under one chapter only.

Through use of a Chapter 20 proceeding, debtor Curtis Reed Johnson has attempted to retain possession of his agricultural land even though in the Chapter 7 proceeding the bank was granted relief from stay to foreclose its lien, and the debt which was secured by the mortgage on that property was discharged in the Chapter 7 case. The method which he has elected to attempt to do this is not a reaffirmation agreement, as contemplated by Chapter 7, and to which the bank would have been required to consent.[27] Rather Johnson filed a Chapter 13 petition subsequent to his Chapter 7 discharge and proposed a plan in which the in rem remedy which survived the Chapter 7 is to be paid through the terms of the plan. If not prohibited from doing so by judicial construction of either the Code definitions or the good faith standard of 11 U.S.C. 1325(a)(3), this restructuring can be imposed upon the Bank notwithstanding its objection, depriving the creditor of its contractual right to foreclose the lien.

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[25]11 U.S.C. §726 (1982)

[26]*In re Silva*, 82 B.R. 845, 847 (Bankr. S.D. Ohio 1987).

[27]11 U.S.C. §524(c) (Supp. IV 1986)

Clearly the sole purpose of debtor Johnson in filing the Chapter 13 proceeding was to manipulate the Bankruptcy Code to avoid a pending sale of his agricultural land. The Chapter 13 plan deals with no claims other than those of two creditors who have liens on the debtor's property which survived the Chapter 7 proceeding. There has been no material change in the debtor's financial affairs between the filing of the Chapter 7 and the filing of the Chapter 13. Petitioner Johnson's Chapter 20 proceeding is a patent abuse of the purpose and spirit of Chapter 13.

The courts generally hold that successive filings alone do not constitute bad faith.[28] Amicus submits that bad faith should follow as a matter of law, however, where the only debts which will be included in the Chapter 13 plan were either nondischargeable in the Chapter 7 or constitute liens upon the debtor's property subsequent to a Chapter 7 discharge, absent a substantial improvement in the debtor's financial circumstances. The use of Chapter 13 under such circumstances is clearly an abuse of the intended purpose of the Bankruptcy Code. One commentator states:

> One striking fact emerges from the foregoing examination of Chapter 13 plans filed on the heels of Chapter 7 liquidations--*all* such plans patently evidence an abuse of the purpose and spirit of Chapter 13. Clearly the sole purpose in filing such plans is to manipulate the Bankruptcy Code to avoid paying creditors. To the extent any *legitimate* reason exists for a successive filing, that reason should be readily apparent to the court. However, under the typical scenarios outlined above, courts

[28] *E.g. In re Rasmussen*, 888 F.2d at 704.



> should have little difficulty finding that virtually any Chapter 13 plan filed within six years of a Chapter 7 liquidation violates the good faith requirement.
>
> This result should obtain despite the lack of effective specific statutory provisions limiting abusive multiple filings. Courts have recognized that the Bankruptcy Code envisions alternative, rather than cumulative or successive relief, and courts should require debtors to accept the consequences of an election between bankruptcy liquidation under Chapter 7 and rehabilitation under Chapter 13. . .[29]

Good faith analysis under 11 U.S.C. §1325(a)(3) has been dispositive in several recent Chapter 20 cases. The Eleventh Circuit in *In re Saylors*[30] held that a Chapter 13 plan which cured arrearages on a home mortgage was proposed in good faith, even though the underlying mortgage debt had been discharged in a prior Chapter 7 proceeding. When reversing the district court, and reinstating the bankruptcy court's finding of good faith, the court relied primarily upon the bankrupt's increase in monthly income between the filing of his Chapter 7 petition and his Chapter 13 petition. Likewise, the 9th Circuit has identified changes in monthly income between the filing of a Chapter 7 and the filing of the Chapter 13 petition as a "bona fide change in circumstances" which should be examined by the bankruptcy judge to determine

[29] Roszkowski, *Good Faith and Chapter 13*, 46 Bus. Law. at 94-95.

[30] 869 F.2d 1434 (11th Cir. 1989).

whether successive filings are proper.[31] In contrast, a Chapter 13 plan proposing reduced payment of debt held nondischargeable in a prior Chapter 7 was rejected as being in bad faith by the Tenth Circuit.[32] The factors which indicated bad faith were the successive filings, the fact that the debtor was originally not able to meet the jurisdictional limits of Chapter 13, and the fact that upon filing the Chapter 13 petition 12 days after the conclusion of the Chapter 7, the only debt listed was that which was nondischargeable in the Chapter 7. The court concluded that the plan was proposed in bad faith because the Chapter 13 filing "was a manipulation of the bankruptcy system in order to discharge a single debt for de minimis payment under a Chapter 13 plan which was ruled nondischargeable under an immediately previous Chapter 7 filing, when the debtor could not originally meet the jurisdictional requirements of Chapter 13."[33]

Amicus submits that the absence of Curtis Reed Johnson's good faith is established a matter of law by the filing of a Chapter 20 proceeding in which the only debts to be addressed by the Chapter 13 plan are liens surviving the previous Chapter 7 proceeding where there was no change in the debtor's financial circumstances between the filing of the two petitions for bankruptcy relief.

## CONCLUSION

Amicus curiae, the Kansas Bankers Association, respectfully urges this Court to affirm the United States

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[31] *Matter of Metz*, 820 F.2d 1495, 1498 (9th Cir. 1987).

[32] *In re Rasmussen*, 888 F.2d at 703.

[33] *Id.*, 888 F.2d 706.



Court of Appeals for the Tenth Circuit under the Code definition analysis adopted by that Court or under the alternative good faith criteria of 11 U.S.C. §1325(a)(3). Kansas banks, like other creditors, enter into loan transactions secured by real property with an expectation that debtors will not be allowed to manipulate the Bankruptcy Code to frustrate the creditors' contractual right to apply the value of the collateral to satisfy the loan obligation. If the Tenth Circuit's holding is reversed, Johnson will have achieved a goal not intended by Congress when enacting the Bankruptcy Code.

Respectfully submitted,

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